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EMU AND THE SOCIAL ENVIRONMENT¹

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1. INTRODUCTION

On 1 January 1999, the European Economic and Monetary Union (EMU) was created. The currencies of 12 member countries of the European Union (EU) are irrevocably fixed and gradually the national currencies will be replaced by one European currency, first the European Currency Unit (ECU), and later, on 1 July 2002, by the euro. According to Article 2 of the Maastricht Treaty the aim of EMU is to promote 'sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.' From this one may expect a positive relationship between EMU and the social environment.

Will EMU attain its aim? The economic debate on the feasibility of EMU focuses on four major issues: firstly, the loss of macro-economic policy instruments; secondly, the functioning of the labour market as a condition *sine qua non* for a successful EMU; thirdly, the cohesion that is deemed desirable in the EU – convergence between prosperous and less prosperous regions is another condition *sine qua non* for EMU; and, last but not least, institutional convergence. EMU is rather difficult to run unless countries achieve a much higher degree of convergence in social policy. Hence, EMU will result in a number of structural economic and institutional reforms.

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This article addresses the implications of EMU for the social environment in Europe. Related to the social environment the focus is on the quantity and quality of employment, on wages and working conditions, and on the social protection systems. Section 2 analyses the impact of EMU on employment and unemployment. The implications of the loss of macro-economic policy instruments are discussed and the importance of asymmetric national shocks is established. Section 3 addresses the role of the labour market as the major shock absorber within EMU and its implications for wages and working conditions. Section 4 discusses the impact of EMU on the social protection systems. In section 5 conclusions are drawn and some policy recommendations are presented.

2. IMPACT ON EMPLOYMENT AND UNEMPLOYMENT

2.1. Loss of macro-economic policy instruments

Related to the consequences of EMU for employment and unemployment a distinction can be made between the effects during the transition period, and the short-term and the long-term consequences of full EMU. The European Commission studied in detail the possible benefits and costs from EMU. It is concluded that EMU is likely to induce static and dynamic efficiency gains for the participating countries. The euro will help to reinforce the beneficial effects of the single market. Increased competition is expected to lower inflation rates, reduce interest rates, encourage economic and employment growth and reduce unemployment within the EU. EMU reduces the costs and risks of international commercial transactions: elimination of conversion costs and of exchange rate risks arising from the use of separate national currencies. According to the European Commission these costs amount to nearly half a percentage of EU GDP (EC, 1990). Although there are surely economic benefits to be expected from a monetary union, the main driving force behind EMU concerns political considerations. Its aim is also largely political. Monetary union is regarded an engine of European integration (see Fratianni et al., 1992; Feldmann, 1997).

The European Central Bank (ECB) is the supreme monetary authority in the euro area. According to the Maastricht Treaty the primary objective of the ECB is 'to maintain price stability' (zero inflation). Monetarist economists notably *believe* that there is a negative relationship between prices and output: hence low and zero inflation is an essential, or at least a very important, condition for high and sustained growth (see, for example, Friedman and Schwarz, 1982). On the basis of a cross-country analysis, Stanner (1993), however, concludes that there is no empirical evidence for this belief. Monetarist economists, moreover, reason that the downward sloping Phillips curve – representing the trade-off between the rate of inflation and the unemployment rate – refers to the short run; the long-run Phillips curve is vertical at a certain long-run unemployment level.³ Hence in the short run the policymakers have to choose between unemployment or inflation, while in the long run the only choice for macro-economic policy is the rate of price and wage inflation. Akerlof et al. (1996) ask the question whether zero inflation is an appropriate target for monetary policy. Their simulations suggest that the lowest sustainable unemployment rate is achievable with a moderate, low and steady inflation rate. With zero inflation the sustainable unemployment rate is measurably higher and real output and employment are sacrificed. When inflation is zero, real wage reduction can only occur through nominal wage reductions. However, nominal wages are downwardly rigid because of money illusion.⁴ Hence, the Phillips curve may be vertical down to a certain minimum value of inflation, whereas below this rate the curve is strongly downward sloping. The inability of employers to achieve wage reductions causes unemployment. In line with this De Grauwe (1998) concludes that within EMU a two to three percent inflation target is more appropriate than zero percent.

The pursuit of the five convergence criteria⁵ established for entering EMU in the Maastricht

³ Later called the non-accelerating inflation rate of unemployment (NAIRU) or the natural rate of unemployment. The natural unemployment rate is determined by the labour market and other institutions that affect structural-frictional unemployment, including individual preferences and endowments, characteristics of firms and government programmes.

⁴ Money illusion implies that purely nominal changes are mistakenly, but rationally, perceived as real changes.

⁵ These five criteria are: average consumer price inflation rate does not exceed by more than one and a

Treaty is often considered to be the implementation of sound economic policies (cf. Vinals and Jimeno, 1997). However, the Maastricht convergence strategy applied by most EU countries – restrictive monetary policy and restrictive fiscal policies (raising taxes or reducing public spending) – created deflationary bias during the 1990s. The resulting drop in European economic growth led to a higher level of unemployment. It intensified the recession in the first part of the 1990s (De Grauwe, 1998). The size of the short-term impact of fiscal consolidation on employment and unemployment varies across countries – given their different economic structure and present fiscal situations – and also critically depends on which kind of measures are implemented, and on how they are implemented (Vinals and Jimeno, 1997).

In addition, the Stability and Growth Pact of 1997, requiring Member States to establish a budgetary equilibrium or surplus in the medium term, has a deflationary impact. Government budgets are robbed of part of their automatic stabilisers, thereby aggravating recessions. A fundamental criticism against the Stability Pact – based on the ‘formula of Domar’ on the relationship between the size of the budget deficit and the debt to GDP ratio – is that it implies that the new EMU norm for the public debt to GDP ratio is set at zero percent instead of sixty percent (see for instance De Grauwe, 1998). The reduction of the public debt to zero inevitably also imply cuts in government investments in human and physical capital. A slow down of economic growth and hence job growth is the result. So, EMU results in a reduction in economic growth and more unemployment, not only in the transition period, but also in the short run and in the long run after establishment as well.

The quality of the new jobs may also be a cause of concern. The proportion of temporary jobs in total employment has been increasing steadily year after year in virtually all EU Member States since the late 1980s. Between 1994 and 1998 temporary jobs accounted for eighty five percent of the net addition to male employment and forty percent to female employment in the EU. The percentage of employees with fixed-term contracts increased from ten percent in 1990 to

half percentage points the average of the three member states with the lowest inflation rate; long-term interest rate does not exceed by two percentage points the average interest rate of the three countries with the lowest inflation rate; maximum government budget deficit of three percent of GDP; maximum government debt of sixty percent of GDP; exchange rate within the normal band of the Exchange Rate Mechanism (ERM) for at least two

thirteen percent in 1999. The employment growth of men and women in the 1990s has also mainly been in part-time jobs. In the EU the proportion of part-time employment in total employment increased from fourteen percent in 1990 to eighteen percent in 1999 (see Delsen, 1995, 1999; EC, 1999). Considerable numbers of these new part-time jobs were for only a few hours per week. EMU intensifies competition and hence the growth of temporary jobs (agency work, fixed-term and labour-on-call contracts). These jobs offer the opportunity to shift the burden of costs and uncertainty from the employer towards the employees, indicating a deterioration of the European social environment.

Apart from economic benefits, the establishment of EMU also is accompanied by one-off as well as permanent costs. The first relate for instance to the physical costs of the switch towards the new currency. The variability of exchange rates is an important balancing mechanism between economies which are at different stages of development and which have different economic and institutional structures. However, EMU implies that exchange rates as an automatic equaliser are no longer available. EMU also implies that the present 12 Member States have lost their monetary sovereignty. The latter may be an important disadvantage and represents the permanent costs of EMU. Shocks in the labour markets may give independent central banks an incentive to use monetary policy. However, EMU reduces the wage restraining role of retaliatory interest rate increases by the national central banks. Inflation and unemployment may be the result. Monetary policy of the ECB aims at price stability in the whole EMU and is not available to accommodate asymmetric national shocks. Budgetary policy also cannot be used in the first years of EMU to absorb asymmetric shocks. Employment will be adversely affected; particularly in those EMU countries in which asymmetric shocks are most likely and in which labour market rigidities are most pronounced.

2.2. Asymmetric economic shocks and labour market flexibility

Economic theory is divided about whether economic integration and monetary union induces or hampers economic convergence. If the sectoral structure of production deviates strongly, crises

in certain sectors will differentially affect the different countries. Research by Bayoumi and Eichengreen (1992) shows that, between 1960 and 1988, asymmetric shocks were higher in the EU than in the U.S.A. Even in the core region around Germany, including Belgium, Denmark, France and the Netherlands, the asymmetry was greater than in a comparable core region of the U.S.A., and that the economic development in these countries differed from those in the United Kingdom and Ireland, and the Southern European states of Spain, Portugal, Italy and Greece. Helg et al. (1995) draw similar conclusions. They make a distinction between country specific, industry specific and local shocks, and find that, in terms of local industry developments, country developments dominate over industry dimensions. This seems to indicate that asymmetric shocks are more common than symmetric shocks. EMU may strengthen this trend, when the Member States increasingly specialise in producing goods and services in respect of which they have comparative advantages. In particular, the sectors whose production is subject to economies of scale could become more regionally concentrated in the monetary union (see Krugman, 1991). In addition, also the existence of 'agglomeration economics' where production tends to cluster geographically due to the existence of numerous production linkages, tends to lead to stronger core-periphery patterns. Hence, the heterogeneity of economic structures is likely to increase under EMU. This also implies that the probability of asymmetric national shocks is likely to increase within EMU. This tendency may be reinforced by enlargement of EMU and may cause instability.

More recent research shows that the EU is evolving into a Europe of the regions. These economic regions are often trans-national. Forni and Reichlin (1997) and Vinals and Jimeno (1997) both found that regional shocks are at least as important as national shocks in explaining short- and long-term movements in unemployment in the EU. Fatás (1997) found that, relative to asymmetric shocks, the number of common shocks increases in time. His research also shows that the economic significance of the national borders decreases over time. Sectoral shocks are also of importance. Marimon and Zilibotti (1998) found that sectoral effects account for eighty percent of the long-run variations in employment growth across countries and industries, whereas country-specific effects only account for twenty percent. The introduction of the Euro likely implies that competition for jobs and capital investment among (cross-border) regions

increasingly replaces competition among individual EMU countries (see Rees and Sonnenholzner, 2000).

In order to avoid negative shocks from resulting in structural unemployment in certain sectors and regions, flexible labour markets are conditions *sine qua non*. Blanchard and Katz (1992) found in the U.S.A. that the effect of regional employment (asymmetric) shocks was mainly compensated for by migration and not by an adjustment of wages. Consequently, they argue, balancing the labour market in the future EMU will be much more difficult. If even in the U.S.A., where wages are much more flexible, the wage mechanism does not considerably contribute to offsetting regional imbalances, this will be even more difficult in Europe. Moreover, labour mobility in Europe, as well as within individual countries, is much lower than in the U.S.A. Eichengreen (1990) found similar results. Particularly in Europe regional shocks have persistent effects, partly due to the low propensity of workers to migrate away from regions where unemployment exceeds the local natural rate (Obstfeld and Peri, 1998; Décressin and Fatás, 1995). Moreover, fiscal federalism in the U.S.A. acts as an automatic regional stabiliser through taxes and transfers. The federal budget is relatively large. Federal taxes and transfers cushion regional GDP shocks. A region in the U.S.A. that is hit by an adverse shock receives more transfers and pays less taxes, while the opposite holds for a region which experience a favourable shock. Because of the current small size of the federal EU budget there is little or no automatic stabilisation from federal fiscal taxation and government spending. Absence of automatic fiscal stabilisers and of labour mobility implies that the monetary union in Europe will *ceteris paribus* result in higher unemployment rates. However, the impact varies between Member States. European budgetary transfers provide the participation countries in EMU a cushion against asymmetric macro-economic shocks. Van Aarle (1996) shows that in the EMU fiscal transfers might successfully act as a substitute for the shock-absorbing capacity of exchange rate realignments and for the automatic stabilising role of federal government spending and taxation that occurs in a mature fiscal federation.

Table 1. Classification of EU countries* by vulnerability to asymmetric shocks and labour market flexibility

Labour market flexibility**			
		High	Low
Probability of asymmetric shocks	Low	<i>Group 1</i> Netherlands, Austria	<i>Group 3</i> Germany, France Belgium (Denmark)
	High	<i>Group 2</i> Ireland, Portugal (United Kingdom)	<i>Group 4</i> Finland, Italy, Greece, Spain (Sweden)

*Non-EMU members in parentheses.

**Relative to EU average.

Source: Dohse et al., 1999.

Although differences in sectoral and regional development are becoming more important, this does not mean that the asymmetry between countries has disappeared. Asymmetric national shocks cannot be excluded altogether. So, the loss of national macro-economic policy instruments represents a risk. Moreover, the desired cross-border regional and sectoral consultation structures to co-ordinate wage developments are not (yet) available. Increasing unemployment rates and a growing polarisation between strong and weak sectors, and between core and peripheral regions, may be the result. This is a threat to EMU, for economic and social cohesion worsens when regional disparities increase. Table 1 shows that EMU involves a substantially higher risk of increasing unemployment for Finland, Greece, Italy and Spain, than for Austria and the Netherlands, while France, Germany and Belgium are in an intermediate position: rather low labour market flexibility and below average vulnerability to asymmetric shocks. The likelihood of asymmetric shocks is considered high in the case of striking peculiarities; for example, in terms of production, and export structure, and dependence on commodity imports. Labour markets are considered inflexible if wages are rigid, working time is inelastic and the geographical mobility of workers is low. The fact that countries differ in terms of labour market flexibility implies that even a common shock in the EMU area will have different consequences for unemployment.

3. IMPACT ON WAGES AND WORKING CONDITIONS

3.1. Wage flexibility and wage moderation

Unlike financial policy, social policy in Europe is mainly national policy. Authority is not substantially transferred to European decision-making and is a cause for policy competition. In this respect, social dumping refers to unfair competition between national systems caused by differential wages, working conditions and social costs. Countries with low social standards, and hence lower labour costs, have a comparative advantage. This comparative advantage gets more weight in EMU. Countries are tempted to continuously adjust to shocks by wage cuts, and cuts in social contributions and taxes and hence the social protection system in order to attract foreign investment and to make home-located firms more competitive. More transparency will increase competition in social security programmes. So, social dumping is likely to get worse under EMU (Miller, 1993; Berghman, 1996; Guillaume et al., 1996).

Members of a successful monetary union should have flexible labour markets. Because of the low intra-EU labour mobility, wage negotiations are the only instrument to take over the role of the exchange rate instrument within EMU to offset differential trends. Any change in the national nominal wage level will directly affect the relative unit costs for a given development in productivity: in a monetary union nominal wage policy equals real wage policy. Hence, the social partners will be responsible for the level of employment to an even greater extent than before. EMU forces social partners to base their wage policy on productivity and unit costs (Rhein, 1995). In fact, the regional competitiveness is at stake when, within EMU, nominal wage increases are not restricted by the expected productivity increases in the own country and the unit wage costs in other countries. Horn et al. (1999) argue that such a productivity-oriented wage policy not only allows the countries lagging behind to catch up with the high productivity level countries, but also promotes Europe-wide economic growth. All EMU member countries have to follow this rule. However, this is not yet the case. In particular, in the Southern

European countries wage finding is different from the rest of the EMU (see also Schramm, 2001). These differences in national wage-setting procedures imply that convergence of price developments can only be reached by divergence in unemployment rates.

In the 1980s the internationalisation of the economies and the accompanying increase in competitive pressure and scaling up on the product market resulted in a decentralisation of wage bargaining in Europe (Hartog and Teeuwes, 1993). EMU intensifies competition between companies and enables firms to take more advantages of economies of scale. That is why EMU is likely to encourage the further decentralisation of collective bargaining to the workplace level. At the same time, EMU will encourage the further Europeanisation of bargaining (EIRR, 1999). Empirical studies show that decentralisation and reduced co-ordination of wage bargaining in Europe reduce real-wage flexibility at the national level, but does not increase regional real-wage flexibility (Schramm, 2001). To create the wage flexibility required for monetary union means the abolition of the legal extension of the provisions of a collective agreement to cover employers and employees not party to the agreement. EMU might widen the income gap between EU member countries and regions, which will undermine the political support for the European integration process. For example, in Portugal labour productivity is only thirty-five percent of the level in West Germany (Nunnenkamp, 1999). Also Greece, Spain and Ireland are countries with the lowest productivity levels. However, co-ordination is the most realistic route (EIRR, 1999; Feldmann, 1997; Obstfeld and Peri, 1998). In fact, the European Metalworkers Federation (EMF) already took the first steps in this direction in December 1998 by adopting the 'wage co-ordination rule' for the collective bargaining by its member organisations in the metal sector across Europe. In the 'Doorn declaration' (September 1998) trade unions of the Benelux and Germany agreed to intensify co-operation and co-ordination related to wage policy and collective labour agreements. The major aim of this co-ordination is to prevent underbidding.

EMU-wide wage bargaining is desired to reduce the damaging regime competition and to limit cross-border migration. Moreover, sharp movements in intra-EMU wages or

competitiveness levels would undermine support for the single market. There will be a tendency to increase wages in the economically weaker countries in the monetary union to the levels of those in the countries with stronger economies. Employers and employees in the richer countries will support this because they benefit from it. Trade unions and employees in the poorer countries will use the higher level of wages as the benchmark for their own wage claims. This convergence, i.e. upward harmonisation in wages will result in costs increasing more than productivity gains. Indeed, in the second half of the 1990s and in 2000 and 2001 productivity growth in the low-wage countries Portugal, Greece and notably Ireland was clearly above the EU average. Also nominal wage increases were well above the EU average in these countries. This indicates an upward convergence of productivity and wage levels in Euroland. However, as a result also the annual growth of unit labour costs in Greece, Ireland, Portugal and also Spain is above average, indicating a deterioration of competitiveness, which can result in a slower economic growth and job losses (Kabki, 2001). Moreover, the desire for wage harmonisation will bring increased demands for transfer payments to the weaker countries. This will reward and stimulate inappropriate behaviour by trade unions (moral hazard). Moreover, in the richer countries the taxes have to be raised to finance the increasing inter-country stabilisation transfer payments, reducing incentives, weakening growth and, finally, undermining the ability to make transfer payments to the poorer countries. At Medio 1999 in Helsinki the European Trade Union Confederation (ETUC) agreed to conclude international collective agreements within five years. The introduction of the euro was the main cause for this unity in the ETUC. This co-ordination of wages not only avoids competition between European trade unions and hence underbidding, but it also prevents an upward wage spiral due to the absence of retaliatory interest rate increases. However, this co-ordination of wage bargaining at the European level also makes it impossible to create additional jobs or retain jobs in a country by means of wage moderation at national level in response to a national asymmetric shock. Structural unemployment may occur.

In 1994, at the Top in Essen the European Commission recommended a wage moderation policy to the Member States in order to create jobs. Wage moderation implies real wage increases below productivity increases. In the first half of the 1990s, in the majority of the EU

countries, wage moderation was applied not only to create jobs but also as a result of the preparation for entry into monetary union (Fajertag, 1997). However, in Germany the policy of wage moderation came to an end, partly because of disappointing employment results, partly because of the loss of monetary autonomy. IG Metal recently abandoned the wage moderation strategy in order to prevent wage dumping (Kabki, 2001). In Denmark, the Netherlands and the U.K. the tightening labour market creates an upward pressure on wage that hampers wage moderation. After the introduction of the euro a policy of wage cost moderation becomes even more effective to improve the country's competitive position than in the transition period. However, reliance on low pay for jobs or competitive survival may imply falling into a low-productivity trap. Wages not only represent a cost factor, they are also a source for effective demand, and provide employers and employees with positive incentives to innovate and to increase productivity. Application of wage moderation by all EU countries may imply a deflationary spiral and cause a Europe-wide recession, as well as a loss of economic growth (Delsen and De Jong, 1998; Horn et al., 1999), making EMU more unpopular. Moreover, wage moderation does not necessarily result in additional investments and hence in more jobs. Under the present circumstances it is more likely to result in greater return on capital, i.e. higher shareholder value.

3.2 Working conditions

Within the EU there are considerable differences with respect to the work environment. In the Northern countries (Belgium, Denmark, Germany, Luxembourg, the Netherlands and the United Kingdom) the quality of the work environment is above average. In the Southern European countries (Spain, Portugal, France, Italy and Greece) and Ireland, the overall quality of working life is below average. Smulders et al. (1996) explain these inter-country differences by economic factors (GDP per head) and cultural factors (norms and values). The differences in national systems act as an incentive for companies to practice social dumping. Jobs may be or threatened to be relocated to regions where labour is cheapest and least protected, with the risk that in due course the national systems will be harmonised on the lowest level of protection (Guillaume et al., 1996). In the EU Member States temporary workers and short part-time jobs

are not always fully covered by employment protection law and social security. This results in an increase in marginal jobs (insecure, short, part-time jobs and temporary jobs). Poverty and dependency may be the result. The differences in the national labour law and social security systems regarding part-time work, fixed-term contracts and agency work are likely to result in an increase of the distortion of competition and social dumping. For instance, temporary employment businesses could recruit a temporary employee on one side of the frontier for the purpose of providing services to a company in the neighbouring country, but not comply with the rules in force of that country (Delsen, 1995). The volume of trans-national temping is likely to increase after the introduction of the euro. Competition between the Member States may lead to the weakening of health and safety protection (O'Reilly et al., 1996). In addition, competition between trade unions on working conditions may be expected. The prospects for pay freezes and pay reductions in the high wage countries seems remote. The decentralisation of wage bargaining towards the enterprise level increases the power of the 'insiders'. Employment will take the brunt, with managers and employees ('insiders') protecting themselves at the expense of those not in work ('outsiders') by adjusting working time and/or the number of employees to achieve comparable levels of unit costs rather than reducing pay (see EIRR, 1999).

European minimum standards of working conditions and social protection are necessary to counteract the incentive towards social dumping in EMU. Social minimum conditions also help to eliminate social inequalities across Member States and, therefore, solidify the European Union. Abraham (1996) questions these arguments for a social union. Social harmonisation reduces the ability of lower-income countries in the EU to make full use of their comparative cost advantages, and thereby to catch up with more advanced economies. The European social dimension may result in economic divergence; a widening of the regional income gap. Snower (1996) argues that the implementation of the 'Social Charter' by the European Commission will help the established, incumbent workers (insiders) at the expense of the outsiders (the long-term unemployed, the school leavers, the temporary workers). Hence, the Social Charter hurts precisely the people whom it was meant to help.

EMU and the euro accelerate the present shift from the stake-holder capitalism of the Rhineland

towards Anglo-Saxon share-holder capitalism, i.e. a shift from non-market co-ordination via the government or consultation towards market co-ordination via the functioning of the price mechanism. This shift applies to the institutional structure of the labour markets and the product markets, as well as to the financial markets (Delsen and De Jong, 1998), and results in a major change in corporate governance: the focus is increasingly on short-term financial results. Higher profit margins and share-holder value are the main motivation for mergers and reorganisations, and for the selling, closing and buying of business parts. This has major implications for the social environment. Within larger firms co-operation is replaced by competition between departments and business parts: labour is mainly seen as a cost factor and is increasingly becoming a commodity rather than an investment, i.e. human capital. This constitutes the basis for the 'flexibilisation' of labour. Temporary jobs often have poor working conditions (Delsen, 1995; Paoli, 1997; 2001. The latter not only refers to hourly wages, fringe benefits and advancement. Temporary workers also are more exposed to physical hazards and a higher level of work intensity than permanent workers. These still are a primary cause of health problems of workers in the EU. Hence, the in previous section (2.1) reported structural growth of temporary work, partly induced by EMU, implies a deterioration of working conditions.

4. IMPACT ON SOCIAL PROTECTION

There are considerable differences in social protection systems between the EU member countries. In general, expenditure on social protection is much higher in the North than in the South of the EU, reflecting differences in GDP per head and differences in the scale of protection provided. However, social expenditure as a percentage of GDP shows some upward convergence (see Delsen et al., 2000; EC, 1998; Alber and Standing, 2000). National social security systems have firm historical roots and are interwoven with the political, economic and judicial systems and reflect cultural differences. Also vested interests make it highly unlikely that any substantial harmonisation will be achieved in a systematic way. A creeping convergence resulting from indirect pressure rather than direct policies is more likely

(Delsen et al., 2000). The most important impact of EMU on social protection is through its effect on national budgets and spending policy (De Grauwe, 1992; Berghman, 1996). In the transition period towards EMU, in countries with the worst budgetary position – Greece, Spain, Italy, and Belgium – the convergence process is connected with the lowering of their social standards (see Miller, 1993). FNV (1999) reports that the fulfilment of the EMU-criteria was a policy goal of social security reform in Belgium, Germany, Greece, Finland, Sweden, United Kingdom. Also the reduction of costs of the social security system, of the state budget deficits, and the labour cost reduction were a cause for social security reform in the EU over the past years (FNV, 1999; Delsen et al., 2000). It includes a shift from universal and social insurance to selective means-tested social protection and a trend towards ‘residual’ welfare states (see Alber and Standing, 2000; Delsen et al., 2000). In theory a paid job is the ultimate guarantee for social security and a remedy against poverty. Based on this notion the social security systems in the EU put more emphasis on reintegration and the obligation to work. Increasingly benefits are conditional on accepting work or training. However, means-tested social benefits might push the effective marginal tax rate above one hundred percent. It is impossible for benefit recipients to raise their net disposable income by accepting a (better) paid job resulting in unemployment and poverty traps. Also the growth of marginal jobs may imply an increasing number of working poor. The austerity of the social security system induced by EMU (Belgium, Greece, Italy, Spain, France) contributes to this growth of insecure jobs (Delsen et al., 2000). Moreover, within EMU, people could be attracted to emigrate by the prospect of either higher benefits or higher wages in other member countries. The euro makes it possible to directly compare the levels of social security benefits in different countries. This increase in transparency between national social protection systems might make social tourism easier and more attractive. Social tourism – increased flows of labour to the richer regions – may have a major impact on social security in the EU. Adverse selection is the result: countries with relatively high protection (benefit) levels attract high risk individuals, resulting in increasing costs of the social security system. On the other hand, high benefit levels imply high tax and premium rates. The latter induce people with low risks to leave the area or country: the financial base becomes narrower.

However, it is unlikely that social tourism will significantly increase under EMU, because access to benefit payments is still tightly circumscribed, the rights of EU citizens are still ineffective and restricted, and migration is not yet a socially-acceptable option for the greater part of the EU population and its government. To be more specific, free movement of people in the EU is limited to employed people, with the exception of family members. Citizens from EU Member States that are not economically are not free to settle in a Member State. Recipients of unemployment benefits are only allowed to settle in another EU country to look for a job for less than three months, without loss of social security rights. The unemployment benefit is paid in local currency by the home country. This implies there is no incentive for unemployed people in a low benefit/low wage EU Member State to look for a job in an expensive high benefit/high wage EU country. Temporary inverted social tourism from high benefit/high wage countries to less expensive low benefit/low wage countries is more likely. Inactive people without an unemployment benefit or without income are only allowed to settle in another EU Member State when financial guaranties are given by a third party. Unlike in the U.S.A., the vast majority of EU citizens are reluctant to leave their country in search for better living conditions. Differences in language and culture are the most important barriers limiting mobility. Labour migration affecting EU citizens is, therefore, not a significant phenomenon and is currently showing no signs of increasing. Nor is any significant increase in mobility within the EU expected for the future, with the exception of executives and specialists (Miller, 1993; Van den Broeck, 1996; Vandamme, 2000). In theory low mobility indicates little divergence between regions. However, in the European Union there still are large and growing regional disparities. Rates of unemployment vary much markedly between regions in the EU than between countries (EC, 2001). Moreover, the regional and cohesion policies of the European Commission, which have strong political support, are expressly designed to avoid people having to migrate to find work and to enable them to stay in their home region. Increasingly, the policy emphasis has been to reduce regional problems through structural programmes, rather than to encourage migration (EC, 1997). Large-scale intra-European migration is perceived as socially disruptive. According to Obstfeld and Peri (1998) EMU is likely to put in place incentives to remain at home. However, the extension of the EU towards eastern Europe, as well as a relaxation of the

regulation of migration without work, will put pressure on the various social security systems. At present, several EU Member States are adapting their migration policies to cope with specific deficits in labour market supply. With a very few exceptions internal EU migration decreased slightly in the 1990s, while international extra-EU migration recently increased during the 1990s: the level of net migration – the difference between inflows and outflows of migrants - in the EU is increasing (EC, 2001).

In theory the low mobility also implies that the differences in the social security systems within the EU do not really matter. As a considerable part of the wage costs in continental Europe are taxes and premiums, there is a direct link between macro-economic competitiveness and social protection. Intensified by EMU, social dumping may *ceteris paribus* result in social convergence towards an ever lower level, and thus in a general deterioration of social protection within the EU. Social protection and regional cohesion are positively related. So, the social cohesion in the EU is at stake. Such a ‘race to the bottom’ is also a threat to the political consensus that is required for the European integration process to be successful (Abraham, 1996). Alber and Standing (2000) conclude that compatible with the notion of race to the bottom there has been a trend to lower social spending relative to a given level of wealth. European minimum standards can stop the reduction of social protection. Economic convergence is a necessary condition for social convergence. In case of considerable economic differences between Member States, harmonisation of social protection at a high level will imply a relative increase in costs and a deterioration of the competitiveness of the weaker countries. This will increase the existing economic differences, while the aim of EMU is to promote convergence of economic performance.

5. CONCLUSIONS

The implications of EMU and the euro for the social environment are plenty. Firstly, the loss of macro-economic policy instruments may result in a growing polarisation between strong and weak sectors and regional disparities. This divergence of economic performance worsens social

cohesion. Secondly, EMU will have a serious impact on national labour markets. EMU has a negative impact on the quantity of jobs. In the transition period, because of restrictive fiscal and monetary policies, EMU has a deflationary impact. Also the Stability and Growth Pact has a deflationary impact. Apart from this negative short term impact on employment, the Stability Pact also has a negative impact on economic growth and hence employment growth in the long term. The euro will also have a negative effect on the quality of employment. EMU accelerates the present shift towards share-holder capitalism characterised by short-termism. Labour is increasingly considered a commodity. EMU intensifies the growth of temporary and marginal jobs. Thirdly, relating to working conditions, wages and social protection a 'race to the bottom' is set in motion by EMU. None of the countries will actually bear the fruits. As a result of EMU the need for social protection is growing, while, on the other hand, EMU reduces the quality of the social environment and the resources to finance this protection. EMU has conflicting aims. A negative relationship between EMU and the social environment is the result.

EMU puts the desirability of cross border wage co-ordination, and co-ordination of the policy on employment conditions, high on the agenda in order to avoid social dumping. Within EMU minimum standards and social harmonisation clash with productivity differences between EU countries. This might widen the income gap between the Northern and Southern EU Member States, which will undermine the political support for the European integration process. Transfers from the richer North to the poorer South seem unavoidable. This necessitates the creation of a European system of transfers, and hence more involvement of the European Commission in social security. However, a permanent financial stream from North to South may also be a threat to consensus. Automatic stabilisers seem more appropriate: European fiscal federalism seems needed.

EMU is likely to result in earnings below the minimum subsistence level. EMU intensified competition and hence the growth of marginal jobs. These marginal jobs are usually available for lower job levels and have poorer working conditions than permanent workers. Moreover, temporary workers and small part-time jobs are not always fully covered by employment protection law and the social security system. Also the austerity of social security and the

obligation to work will contribute to this increase in the number of marginal jobs. Also the tendency towards productivity-oriented wage policy implies that the threat of working poor and dependency is real. Moreover, the expected growth of temporary work will, in the case of job loss, result in an increase in the number of supplementary benefits up to the minimum level. Workers may fall into unemployment and poverty traps. Because of this Europe will unavoidably be confronted with the problem of a guaranteed minimum income, disconnected from paid work. The social security systems in many EU countries aim at exclusion, rather than a transition towards employment. A reduction in the social burden requires a reform of social security systems. Related to this, I have proposed elsewhere (Delsen, 1997; Delsen et al., 2000) a new concept of full-employment that combines the right to at least a part-time job guaranteed by the government and the legal right to a (partial) basic income, conditional on the acceptance of at least a part-time job. This new concept is not only economically efficient, but is also socially desirable. It can be conceived as an initiative towards a more active labour market policy and an activating social security system.

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